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Global Financial Crisis and Its Impact on Balkans

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Abstract: The aim of writing this paper is to reveal that the implication of the crisis to the western Balkans has been not of a sort of financial crisis, but an economic turbulence which has occurred as a result of lack of demand in the world markets to the western Balkan products and falling sources of finance. Expansionary fiscal policies on top of external trade deficits growing at record levels, calls into question the ability of the western Balkan economies to finance the needs, that in turn increases their vulnerability and that may lead to a possible financial crisis in future if the global financial crisis continues to sustain until 2010. What is expected to ease the conditions is the seasonally strong increase in construction, food exports and private transfers during the spring and summer seasons, expected to close the gaps that are being established through growing external trade deficits. Increase in construction business, growing food exports and raising remittances may offset vulnerabilities of the economies and may limit further economic and financial crisis in the region.

Keywords: global financial crisis; Balkans; growth; unemployment; remittances

Financial Crisis in the World, Economic Crisis in the Balkans

What started as a global financial crisis has become an economic crisis. The world financial crisis emerged from a property bubble and a credit boom. Bad debts soared and banking sector in the developed economies became insolvent. The implication of the crisis to the western Balkans has been not of a sort of financial crisis, but an economic turbulence which has occurred as a result of lack of demand in the world markets to the western Balkan products and falling sources of finance. Investments, remittances, industrial production, foreign exchange reserves and employment rates have fallen. As a result, growth has slowed down. Expansionary fiscal policies on top of external trade deficits growing at record levels, calls into question the ability of the western Balkan economies to finance the needs, that in turn increases their vulnerability and that may lead to a possible financial crisis in future if the global financial crisis continues to sustain until 2010.

The governments of the region of the western Balkans, when the crisis hit in September 2008, argued that they were immune to the crisis. However, as their export-oriented economies began to slump in the autumn of 2008 due to the slid in the world commodity prices, which resulted in tens of thousands of citizens of western Balkan countries loosing their jobs, the governments of the region became more open about the difficulties of their economic situation, although continuing to argue that the effects of the financial crisis are least to be felt in western Balkans in comparison with other regional economies of Europe such as that felt in Iceland, Baltic states or Ukraine. The culprit many of the governments have now settled on is the world out of Balkans. Even wider publics took comfort of this argument due to relatively low exposure of the local economies to the world financial markets.

Although the governments continue to predict that the economies would show growth and small contraction in 2009, the economic indicators show that the economies are in some degree of trouble at the moment with industrial output, foreign investment and remittances falling and unemployment rising.[1] Growth forecasts are down across the region from 5 to 3%, investors are slowing projects and governments are drawing up rescue plans.[2] Independent economists think that 3% growth of GDP for 2009 is wildly optimistic. Depending on the world manufacturing and commodity prices, they could show growth by 2 or even 1% of GDP.

For the small economies of a scale of western Balkans that have boomed for the past seven-eight years, following the end of conflicts in the region in 2001 - that last one being the conflict of Macedonia in 2001 - with

[1] The Economist, "The Balkans: A year in the life of Kosovo", 14 February 2009, p. 14.
[2] The Economist, "The western Balkans: A stuck region", 14 February 2009, p. 36.

annual average GDP growth reaching 5%, economic slowdown and contraction in GDP that has started to be seen starting from the autumn of 2008 is a particularly harsh blow to western Balkans. The whole region, except Serbia and Croatia, has escaped the global financial crisis however it has run into economic crisis due to the recession in its export markets, including EU. As small open economies the western Balkan countries are uncomfortably exposed to the world crisis and particularly to EU as their trade with the EU member states comprises their largest trade volume. Since the global financial crisis hit in September 2008 growth has turned to contraction and unemployment is mounting in the region. Also, any lingering hopes that the western Balkans might escape relatively unscathed from the global financial storms were dashed when managers of the foreign banks in the region, mainly those of Austria and Greece, sought support from the international finance institutions. This shows that, although the economies are small and relatively well protected, they are exposed to the global financial crisis that has been replicated in the region in the form of economic crisis.

The falling manufacturing and commodity prices in the world markets are causing problems. Depended on steel and metal exports, the region has been hit hard by the global slump in commodity prices and by the expensive imported electricity, sending metal prices into a tailspin. The price of the metals has fallen by almost two-thirds since mid-2008 leading to slowdown in the region's economies. More than a fifth of economic output and employment are based on exports, making them particularly vulnerable to a fall in global growth and trade. Manufacturing and exporting economies are grinding to a halt, as demand across the world melts away. The western Balkan economies contracted further in last quarter of 2008, as a dispute between Russia and Ukraine over gas prices reduced energy supply to the region and forced the countries' heavy industries to go slow, cutting production or even halting assembly lines. For example, Silmak, a significant producer of ferro-nickel in Jegunovce, in the western part of Macedonia, has cut production and has laid 700 workers due to the drastic fall of the ferro-nickel's price in the world markets.[1] The nearby brick factory Kiro Kucuk in Veles, in the central part of Macedonia, also exemplifies the gravity of the setback. On 1 March 2009 the employees turned up for their final day's work. The factory will not reopen until the economy recovers.[2] A similar story could be told in many countries of the region. Macedonia is not alone depended on exporting metallurgical industries. Serbia has suffered far more as global demand for the goods in which its industry specialises has evaporated. For example, US Steel, one of Serbia's leading exporters, closed one plant.[3] These examples are reflection of the data released for January 2009 that industrial production, which accounts for a fifth of total value added in Macedonia[4] and Serbia has plummeted by 17%, its steepest fall in years.[5] The Macedonian State Statistics Office reported that the local companies have been operating by using 50% of their capacities in the course of January 2009 and their situation has deteriorated on a monthly basis, which has led to a drop in employment rate as well as a large fall in production due to the reduced foreign demand for Macedonian products, insufficient domestic demand, uncertain economic situation and the financial problems. These are hotbeds that might be transferred to other economic sectors, such as the textile and leather industry and to the construction sector, which comprise large share in the country's GDP.

The gloom reflects growing worries about underlying weaknesses that make the countries especially vulnerable to recession happening in the EU and other economies to which Balkan economies are depended.

So companies have announced big lay-offs as demand has fallen and factories have closed.[6] The official unemployment figure of Macedonia already stands at 33% (unofficially it is probably 35% or more) and is set to rise as the new basic salary estimates will only count employed those who pay social security benefits. Unemployment rate in Bosnia and Herzegovina and in Kosovo are more than 40%. The unofficial unemployment rate is, however, much higher and many who say that they have jobs are in fact on indefinite unpaid leave. The economists forecast that unemployment region-wide will rise. Most of that rise will be the result of fall in trade (many exporting companies have laid off workers), and due to declining investments.

Coffee streets from Knjez Mihajlova in Belgrade to Kej Vardar in Skopje to Bash Charshija in Sarajevo are busy during sunlight as young people, forming more than 50% of the unemployed force in the region, sip their coffees. Unemployment rates are soaring and offices of the Employment Agencies in whole region are full with people looking for work.

The stock markets have plunged as well. The Zagreb stock exchange index lost 42% during the last quarter of 2008 and others such as Sarajevo Stock Exchange, dropped by 19% during the same quarter, leading

[1] Dnevnik, "Silmak prekina so rabota", 2 Mart 2009, p. 7.
[2] Utrinski, "Rabotnicite od Kucuk izvisija", 3 Mart 2009.
[3] European Commission, DG ECFIN, EU Candidate and Pre-Accession Countries Economic Quarterly, 9 January 2009, p. 30.
[4] Ibid, p. 10.
[5] Utrinski, "Pad na proizvodstvoto za 16.7%", 27 February 2009.
[6] International Monetary Fund, "Former Yugoslav Republic of Macedonia: Staff Report for the 2008 Article IV Consultation", Prepared by Staff Representatives for the 2008 Consultation with Former Yugoslav Republic of Macedonia, 11 November 2008, p. 11.

to an annual decrease of 67% in 2008.[1] The Belgrade Stock Exchange tumbled and its index lost 75% during 2008.[2]

An important sector that waits to be affected is the real estate market as the credits have gone down and the borrowers are unable to pay back their monthly loans. The scale of the bubble in the region is as big as in troubling EU cities. House prices rose further in Belgrade than they did in Tirana. So did commercial-property prices. As a result, demand for new homes has dried up although prices have remained stable and over inflated, with Belgrade topping the prices where average residential square meter is sold at 2000 euros. The housing boom in the region is among the extreme, measured by real price increases and resulting overvaluations. This is a bubble which is waiting to burst. Another bubble which is waiting to burst is commercial property where office blocks and shops are overvalued. Both these booms have been fuelled by debt, another reason why the region looks particularly vulnerable now.

There is much to suggest that the pain is felt most by small enterprises, labelled as small and medium sized enterprises (SMEs) that are the backbone of the western Balkan economies. SMEs seem especially vulnerable to the downturn. Many specialise in textile and these are also the products whose orders are the first to be cancelled when economies slow and companies trim investment. These firms are finding themselves chronically short of orders and capital.

The governments in the region have launched actions to stimulate their economies. Montenegrin government launched a plan with significant capital expenditures and other stimulus to businesses at some 10% of the projected GDP for 2009.[3] In November 2008, the Macedonian government unveiled measures worth 5-6% of GDP.[4] Other governments as well have unveiled packages that include extra billions to finance investment, infrastructure projects, extra benefits for poorer and tax cuts. The central banks as well have joined in tightening monetary policies and increasing controls of the credit markets. These measures mean the economy may suffer only a mild downturn. Tightening of control by the central banks has encouraged banks to drastically decrease the amount of lending. When there are no loans for companies and consumers, the consumption of domestic and foreign products decreases, leading towards economic stagnation. So officials are also trying to inject cash and confidence into the banking system, avoiding confidence crisis that in October 2008 hit Albania, Bosnia and Herzegovina, Montenegro and Serbia where the lack of confidence led to a withdrawal of deposits by population.[5] They have done this in various ways. Croatian central bank has abolished reserve requirements. The Bank of Albania has limited Banks' exposure towards their foreign parent companies.[6] The National Bank of Serbia has eliminated the tax on savings income to help boost foreign exchange liquidity.[7] The Bosnian central bank has increased the level of guaranteed savings deposits from 3500 to 10.000 euros and the Montenegrin government has given full guarantee to deposits. The Montenegrin government has also given capital boost to ailing Prva Banka to allow it to expand landing, especially for small businesses.[8]

The global crisis has slowed down western Balkans' credit-fuelled boom. Estimates of output have slumped and currencies have dropped as capital inflows have dried up. The bad debts have raised as local customers default particularly those that have borrowed in foreign currencies that have since risen relative to their own. One of the dirty habits from the boom is that as local loan growth outpaced deposit growth.[9] There is likelihood that one or more of the ex-communist Balkan countries will default on its debt. The biggest weakness lies in a financial system that has combined badly run local banks with loosely overseen subsidiaries of western ones. Some local banks now depend on their parents' willingness to keep financing them – and those parents have plenty of problems at home. The Greek government has told its banks to draw back from their lending in the Balkans. Debt burdens are high today because so much was borrowed in the recent past. This began as a logical response to declining interest rates, low inflation, rising asset prices and less frequent recessions. Some countries have an extra problem of big external government debts (in Croatia's case, the gross figure is near 85% of GDP). For other countries, the strong Euro is a problem; they have pegged their currencies to it.[10]

Tumbling exchange rates raised the real burden of foreign-currency loans, forced policymakers to keep interest rates high. However, by boosting exports, a weaker currency can offer a route to recovery. In Macedonia, by contrast, denar stays strong as the economy slumps, deflation setting in which will lead debts to grow and possibly banking problems to grow. Possible threat of financial crisis has led the Euro to be seen as a shelter for western Balkan economies from the storms. The local currencies *dinar of Serbia, kuna of Croatia, lek*

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[1] European Commission, DG ECFIN, p. 23.
[2] Ibid, p. 31.
[3] Ibid, p. 26.
[4] Ibid, p. 10.
[5] Ibid, p. 3.
[6] Ibid, p. 18.
[7] Ibid, p. 31.
[8] Ibid, p. 27.
[9] The Economist, "Eastern European banks: The ties that band", 21 February 2009, p. 73.
[10] The Economist, "Eastern Europe: Argentina on the Danube?", 21 February 2009, p. 14.

of Albania have lost their value against the Euro. Kuna depreciated by 2.9% and lek 1% vis-à-vis the euro in the last quarter of 2008,[1] where as the Serbia's dinar has lost close to 17% of its value against the Euro in the same period. The central bank of Macedonia has spent over 50 million euros of its reserves in January 2009 alone, largest since the introduction of denar in early 1990s, to cushion the devaluation of its currency and avoid public panic.[2] Macedonia will suffer damages if the Euro loses its value in relation to the dollar as it would affect the Macedonian export to EU markets. The increase of the dollar value will also have negative implications for Macedonia as the country uses this foreign currency to purchase twice as much as it sells. The value of the Euro in comparison to the dollar has been declining since autumn 2008. The drop of the value of the Euro with this fixed course of the denar in relation to the Euro currency will damage the Macedonian economy and de-motivate exporters primarily exporting to EU states.[3] The government in Macedonia also has shredded investor confidence by calling for decreasing the amounts given to private pension funds.

Recovery is possible only through strong demand in the rest of the world (which is to lack for some time), that would lead exports to soar, allowing quick recovery. However, today demand is falling rapidly across the globe and most big developed economies buying Balkans products face simultaneous banking crises. With demand weak everywhere, the familiar route to recovery is blocked.[4] For the largest trading partners of western Balkan economies, the EU countries, figures that came out in February 2009, showed that Euro-area GDP shrank at an annualised rate of around 5% in the fourth quarter of 2008. The IMF has forecasted that Euro-area GDP will decline by 2% in 2009 and barely recover in 2010. Countries with huge current-account deficits are most exposed in a credit drought. So the hope had been that weaker economies of Balkans would be offset by faster economic recovery in EU economies and support by the local banks mother banks' in EU. Unfortunately, the EU economies are facing recession and mother banks and mother countries have asked them to lend first to domestic businesses and households and not to transfer money to their subsidiaries in Balkans. The Greeks publicly advised banks to be more prudent about transferring bail-out funds to Balkan subsidiaries.[5]

The western Balkan countries face a current account deficit this year in average of around 14%. Nevertheless, the crisis for example has not stopped the Macedonian and Kosovar governments from doling out billions of euros' worth of cultural projects.

Financial crisis is also having effect on remittances, a large share in GDP of the economies of Balkans. Foreign workers have been first to be laid off in the western economies. Remittances make up more than a tenth of the GDP of Balkan economies. Although they are likely to fall as a result of the slumping world economy, as it has been the case with Albania, where remittances' inflows have declined from 13% of GDP in 2007 to 11% of GDP in the last quarter of 2008,[6] they may be less affected by the world economy.[7] It is expected that people keep the cross border payments going even when their incomes fall. Migration from western Balkans to EU countries is expected to rise as the borders are getting opened through visa facilitation and liberalisation programmes. However, this rise will be balanced with the recession in the EU economies where it means fewer jobs for migrants.

In surveys, the economy has leapt to the top of voters' concerns. Overall the public is scared and uncertain. So far, the Balkans has escaped the civic unrest seen in the Baltic States, Iceland, or elsewhere.[8] There are not yet signs of discontent, except concerns expressed by politicians and economists. Thousands taking to the streets to protest against crises in Baltic States and Ukraine have not resembled in Balkans. However, pundits predict unrest in towns that rely entirely on one ailing factory or industry. But so far the signs are limited.

The middle class in the whole region is under a great threat. The middle class flourished during communist times. As economy goes into reverse they may well be hit harder than the rich or poor. They work in export industries so their jobs are unsafe. The other part of the middle class, who are employed in the state administration, and whose jobs are relatively safe, they have started to borrow, so are hurt by the credit crunch.

To End with a Negative and a Positive Note

The economies of the Balkan region, except those of Serbia and Croatia, have escaped the financial crisis. However they are facing the biggest economic crisis since 1991, when they left the communism regime. Corporate profits have collapsed. Big manufacturers' output is down. Metal producers have halved or halted their

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[1] European Commission, DG ECFIN, p. 7.
[2] Biljana Krstevska, "Stopeni uste 53 milioni evra", Dnevnik, 27 February 2009; Utrinski, "Samo so dobra plata do kredit", 27 February 2009.
[3] Abdulmenaf Bexheti, "Experts on Fixed Course of Denar", Skopjediem, 25 February 2009.
[4] The Economist, "America's banking crisis: Worse than Japan?", 14 February 2009, p. 76.
[5] The Economist, "Charlemagne: Single-market blues", 7 February 2009, p. 30.
[6] European Commission, DG ECFIN, p. 19.
[7] The Economist, "Remittances: Trickle-down economics", 21 February 2009, p. 74.
[8] The Economist, "The western Balkans: A stuck region", 14 February 2009, p. 36.

production. Companies have slashed jobs and investment. Industrial output and employment have fallen at record levels not seen since 1991.

What is expected to ease the conditions is the seasonally strong increase in construction, food exports and private transfers (workers remittances) during the spring and summer seasons. These seasonal effects are expected to close the gaps that are being established through growing external trade deficits. Increase in construction business, growing food exports and raising remittances may offset vulnerabilities of the economies and may limit further economic and financial crisis in the region.